LE COPY

OCT 21 1929

No. 55.

THE UNITED RAILWAYS AND ELECTRIC COMPANY OF BALTIMORE,
*Appellant,*
vs.
HAROLD E. WEST, Chairman, and J. FRANK HARPER and STEUART PURCELL, Members, Constituting the Public Service Commission of Maryland,
*Appellees.*

No. 64.

HAROLD E. WEST, Chairman, and J. FRANK HARPER and STEUART PURCELL, Members, Constituting the Public Service Commission of Maryland,
*Appellants,*
vs.
THE UNITED RAILWAYS AND ELECTRIC COMPANY OF BALTIMORE,
*Appellee.*

APPEAL FROM, AND CROSS-APPEAL FROM AND PETITIONS FOR CERTIORARI TO, THE COURT OF APPEALS OF THE STATE OF MARYLAND.

# REPLY BRIEF FOR THE UNITED RAILWAYS AND ELECTRIC COMPANY OF BALTIMORE.

CHARLES McHENRY HOWARD,
CHARLES MARKELL,
HENRY H. WATERS,
*Counsel for The United Railways and Electric Company of Baltimore.*

## CONTENTS


PAGE

Introductory ..... 2

I. Value of property..... 2

II. Depreciation allowance ..... 6

III. Rate of return..... 7

IV. Value of service..... 10


## CITATIONS.


CASES:

Bluefield Co. vs. Public Service Commission, 262 U. S. 679 ..... 8

Consolidated Gas Co. of New York vs. Prendergast, 6 F. (2d) 243..... 7

Havre de Grace Bridge Co. vs. Public Service Commission, 132 Md. 16..... 3

Lincoln Gas Co. vs. Lincoln, 250 U. S. 256..... 7

McCardle vs. Indianapolis Water Co., 272 U. S. 400..7, 9

Miles vs. Public Service Commission, 151 Md. 337.... 3

Missouri ex rel. Southwestern Bell Telephone Co. vs. Public Service Commission, 262 U. S. 276..... 6

Smyth vs. Ames, 169 U. S. 466..... 4

Southwestern Bell Telephone Co. vs. Public Service Commission, 262 U. S. 276..... 6

United States vs. Ludey, 274 U. S. 295..... 6

TEXTS:

Moody's Manual of Investments, Public Utilities, 1929 .....7, 8

STATUTES:

Maryland:

Public Service Commission Law, Section 30 [Annotated Code of 1924, Article 23, sec. 385]..... 4

IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929.

---

No. 55.

THE UNITED RAILWAYS AND ELECTRIC COMPANY OF BALTIMORE,
*Appellant,*

vs.

HAROLD E. WEST, Chairman, and J. FRANK HARPER and STEUART PURCELL, Members, Constituting the Public Service Commission of Maryland,
*Appellees.*

---

No. 64.

HAROLD E. WEST, Chairman, and J. FRANK HARPER and STEUART PURCELL, Members, Constituting the Public Service Commission of Maryland,
*Appellants,*

vs.

THE UNITED RAILWAYS AND ELECTRIC COMPANY OF BALTIMORE,
*Appellee.*

---

APPEAL FROM, AND CROSS-APPEAL FROM AND PETITION FOR CERTIORARI TO, THE COURT OF APPEALS OF THE STATE OF MARYLAND.

---

## REPLY BRIEF FOR THE UNITED RAILWAYS AND ELECTRIC COMPANY OF BALTIMORE.

In this reply the Commission's brief will be referred to by page numbers (without other designation) thus [1-139]; the Company's original brief will be referred to thus [B. 1-105].

The Commission's brief presents (*a*) the same contentions as the opinions of the Commission and the Court of Appeals to sustain the Commission's conclusions from its findings of fact, (*b*) contentions, (some made below, some entirely new), contrary to the uncontradicted evidence, the Commission's findings of fact and the Court of Appeals' view of the facts and (*c*) much discussion of alleged facts (especially statistical and other matters not mentioned in any of the opinions in the state courts) that seem irrelevant here. In limiting the scope of this reply the Company does not accept, as either relevant or accurate, statements of fact in the Commission's brief not here discussed.

## I. Value of Property. [20-40, B. 7-10, 12-14.]

The most extraordinary feature of the Commission's brief is an attempt, *made now for the first time,* to repudiate the Commission's valuation of the Company's property, ($75,000,000), accepted by the Commission itself, the Company, the lower state court and the Court of Appeals as the undisputed value of the property. This attempt involves *all* of the following assertions (here stated briefly): (1) the value of the Company's property has been decreased to less than $75,000,000 by automobile "competition"; (2) the Maryland law compels the Commission to ignore any such decrease in making a valuation; (3) the Commission in its valuation of the Company's property did ignore this decrease in value; (4) the Commission's valuation is only the "Maryland value" of the Company's property and on the question of confiscation is not evidence of its "federal value," *i. e.,* real value. Without stopping to consider the logical sequence or legal soundness of these assertions, it is

sufficient that *each* is contrary to fact and unsupported by evidence.

That the value of the Company's property has been decreased to less than $75,000,000 by automobile "competition" is sheer assertion; it does not become anything more by reiteration or by calling it "an indisputable fact" [24]. The property is used by more people than ever before. *Changed use* of the property, due to increased use of automobiles, is *more costly* (per ride, not necessarily per passenger or even per mile), and therefore necessitates *increased fares;* this does *not* decrease value. A man's house does *not* become *less valuable,* though his *changed use* of it becomes *more costly,* when he so prospers as to buy a second house and occupy the first only part of each year. The Commission's brief refers indiscriminately to "value of property," "value of [regulated or unregulated] business" [22, 23], "return therefrom" [limited by law or unlimited], [23] "earning capacity" [22] and "commercial" earning capacity [unlimited by rate regulation] [24, 26].

There is no such thing as "Maryland value." Maryland *property* exists under Maryland law, but is protected by the federal constitution, even against Maryland legislation. If Maryland property, *e. g.,* easements, is different from property rights elsewhere, it is nevertheless so protected. [B. 9.] Value however is value. "Fair value" under the Maryland statute [section 30; B. 107] is the same as "fair value" under the decisions of this Court. [*Havre de Grace Bridge Co. vs. Public Service Commission,* 132 Md. 16, 26-27.] The *Havre de Grace Bridge* case [27-28] was qualified in the *Miles* case [28-30] *only* to the extent of excluding the possibility that in valuation "for rate-making purposes" anything might be *added* by capitalization (directly or indirectly) of earnings. [*Miles vs. Public Service Commission,* 151 Md. 337, 345.] There is no authority whatever for the

assertion that "Maryland value" may be greater than actual value.

In the Company's valuation case the Commission, after thirty-one days of hearings and three days of arguments [R. 281], and rehearing as to value of easements pursuant to the decision of the Court of Appeals, found the "fair value for rate-making purposes" of the Company's property on December 31, 1923, to be $75,000,000 [R. 356]—an amount considerably less than the amount claimed by the Company. The Commission professed to have given "due weight to the various elements which must be considered in determining the fair value of a property such as that of the United Railways and Electric Company as laid down by the United States Supreme Court in the case of *Smyth vs. Ames.*" [R. 282.]

In the instant case the entire record in the valuation case, including several thousand pages of evidence, (*not* the opinion only without the evidence, as erroneously stated in the Commission's brief [12]), was offered in evidence. [R. 62, 361.] The valuation itself is "*prima facie* evidence of the value of said property" in the instant case. [Section 30; B. 108-109.] The Commission in the instant case "after considering all facts which to it seem relevant" finds the value "at the present time" to be still $75,000,000. [R. 49.] In the lower state court and in the Court of Appeals the Commission's valuation was accepted by both parties. Pursuant to the rules of the Court of Appeals, (which like the rules of this Court require the omission of unnecessary matter from records on appeal [Rule 13; 134 Md. 9-10. *Cf.* Rule 5; 134 Md. 4-5]), the record in the valuation case, except the opinions and orders [R. 279-357] and certain specified parts of the evidence [R. 1306-1347, 1349-1379], were omitted by stipulation from the Record in the Court of Appeals in the instant case. [R. 1615-1616, 1618-1619]. The evidence included relates to rate of return; the evidence relating to value of property was omitted because the Commission's

valuation was undisputed. In the supplemental bill [R. 1686], as in the original bill [R. 7-8], the Company averred, and the Commission in its answer admitted [R. 1699], that the Commission had found "the present fair value of the Company's property used in the public service" to be $75,000,000. The supplemental bill, like the original bill [R. 8], also averred the *fact* to be that "the fair value" of the property is not less than $75,000,000. [R. 1686.] These unqualified averments are made with reference to "federal value" and the federal questions raised in the instant case. Never in pleadings, evidence, arguments or briefs in the lower state court or in the Court of Appeals was the existence of more than one value or of a "Maryland value" in excess of "federal value" suggested. As the Court of Appeals accurately says, "$75,000,000 may be treated as *the true value of the Company's property for all the purposes of this case.*" (Italics ours.) [R. 1631, 155 Md. 585. B. 8, 127.] Even if the present contention in the Commission's brief were not wholly contrary to fact and unsupported by evidence, it would come far too late in this Court.

The Commission's brief enhances the confusion of thought in the Commission's opinion by treating (1) *value of property* and (2) *rate of return* as indistinguishable. The Commission's unique argument that risk limits, instead of increasing, fair *rate of return* [R. 38-39] is now quoted as meaning *not rate of return* but *value of property* [23-24]. In any arithmetical computation two errors *may* minimize each other. In this sense the effect of adopting an inadequate rate of return *may* be partly—only by miraculous coincidence exactly—offset by overvaluation of property. But in no accurate or rational sense can loss of value be allowed for by *either* decreasing *value* or decreasing *rate of return.* [22.]

**II. Depreciation Allowance.** [40-57, B. 83-96.]

On this question the Commission's brief cites as supporting the Commission's contention, (*a*) accountants [46-49], (*b*) other commissions [49-50] and (*c*) one special master [53-55] and one inaccurately cited decision of this Court [43-45]. As cost is the ordinary basis of accounting and value the constitutional basis of rate-making, little enlightenment on this legal question is furnished by accountants [B. 94-96]—or by commissions, prone to ignore present value and evade the decisions of this Court. [*Southwestern Bell Telephone Co. vs. Public Service Commission,* 262 U. S. 276, 296-297, 301-302, dissenting opinion of MR. JUSTICE BRANDEIS.]

In *United States vs. Ludey,* 274 U. S. 295, [43-45], an income tax case, the question was not whether depreciation should be computed on cost or value, but whether it should be deducted at all in computing gain from sales. As cost is the ordinary *statutory* basis for computing taxable gain, depreciation must be computed for the same purpose on the same basis. [B. 95.] The case however is cited [44] as authority for computing gain on 1913 value and depreciation on cost of the same property. Both the irrelevance and the inaccuracy of the citation are shown by a footnote at at the beginning of the opinion, expressly stating that as to properties purchased before March 1, 1913 "the term cost is used, throughout the opinion, as meaning their value as of March 1, 1913." [274 U. S. 296-297.]

**III. Rate of Return.** [58-92, B. 28-69.]

On this question the Commission's brief attacks the uncontradicted evidence [58-76] and pronounces "its inherent weight * * * negligible." [76.] This attack really goes (*a*) partly against the *weight* of the evidence, by opposing unsupported assertions contrary to the Commission's own findings against uncontradicted testimony, but *(b)* princi-

pally against the *subject matter* of the evidence, by opposing irrelevant circumstances against the "relevant circumstances" which under the decisions of this Court are controlling. These two lines of attack are not kept distinct. Furthermore assertions as to value of property introduce the same strange confusion of value of property with rate of return as the attempt to repudiate the Commission's valuation [*supra*, 5].

Thus Mr. Hoyt's testimony (in the instant case as in one of the New York gas cases [B. 39, 41]) that an expected return of at least 8 per cent. would be necessary to induce investors to invest their money in the purchase or construction of such a property is assailed because it relates to the Company's property and not to some proposed substitute property. Assertions as to relative values of the Company's property and possible substitute properties are wholly unsupported by evidence. Such assertions relate not to rate of return but to value of property. There is nothing in the Record about substitute properties; if there were, the subject is so remote that such evidence ordinarily would not be useful, even as to value. [*McCardle vs. Indianapolis Water Co.*, 272 U. S. 400, 417-418.]

Mr. Hoyt's testimony is also assailed because as of January 1, 1924, in the valuation case, again in 1926 in the Gas Company rate case and again in 1927 in the instant case he testified that an expected return of *at least* eight per cent. would be necessary and did not attempt to measure any possible differences due to intervening changes in the money market [74-76]. A table of bond prices (in terms of "yield") from 1903 to 1929, taken from Moody's Manual of Investments for 1929, is appended to the Commission's brief [153]. On their face, without expert interpretation, these bond prices for several years past show no change comparable to the difference (judicially noticed in the *Lincoln* gas case) between pre-war and post-war returns, no de-

clining return, no clear trend at all and nothing whatever to impugn Mr. Hoyt's testimony. What is a fair rate of return may of course be affected by changes in the money market, but does not follow all the passing fluctuations in bond prices. The decisions of this Court and of lower federal courts, especially cases cited by this Court [B. 32-39], in "having regard to all relevant facts" [B. 33] have regard not to ephemeral matters but rather to considerations more abiding and capable of more general application. In the instant case the result is the same whether regard be had to the more general or the more particular facts and evidence.

If courts can be expected not only to take judicial notice of any and all financial statistics, but also to interpret their economic significance (distinguishing causes from results), and thereby to disregard uncontradicted testimony of qualified experts, this judicial task is not light and may lead far afield. In the instant case it would at least lead to the statement immediately following (in Moody) the table of bond prices that is appended to the Commission's brief: "The rise in the price of public utility capital was due partly to the unfortunate situation of electric railways, consequent upon the failure of street car fares to keep pace with the advance in operating costs." [Moody's Public Utilities, 1929. Cf. *Bluefield Co. vs. Public Service Commission,* 262 U. S. 679, 694-695, B. 62-63.] It would also lead a few pages farther to a table of "*traction* bond" prices, all showing "yields" much higher than "public utility bonds" in the table in the Commission's brief. [Moody, xxxviii.]

If regard be had to the more general considerations in the instant case, then the uncontradicted evidence that less than eight per cent. is not a fair return is confirmed by the decisions of this Court and by the overwhelming weight of lower federal court decisions, most of which expressly so hold, the rest (with few, if any, exceptions) depending upon smallness of risk or other special circumstances affirma-

tively shown [B. 32-54]. If on the other hand regard be had to the more particular considerations in the instant case, then again the same uncontradicted evidence is confirmed by the also uncontradicted evidence that over a period of years *borrowed* money has cost the Company more than 7 per cent. and this experience is in line with the general situation of street railways [B. 30]. If not less than eight per cent. was a fair return for *other utilities* at *any* of the times when the recent federal cases have so held, then not less than eight per cent. *now* is fair for *street railways* [B. 56].

The uncontradicted testimony of Mr. Hoyt and other witnesses in the instant case not only directly applies the standards announced by this Court in the *Bluefield* case [B. 33], but is (as the Commission's brief states [87]) substantially the same as the testimony of Mr. Hoyt himself and others, followed by federal courts, in other cases. Against *six* such cases, *including one cited by this Court* in the *Indianapolis* water case [86-87], the Commission's brief makes the same attack as against the uncontradicted testimony in the instant case.

The Commission itself never questioned this testimony, but merely tried to escape the *effect* of it by the strange doctrine that risk limits, instead of increasing, fair rate of return and by the other arguments in its opinion [B. 56]. The Court of Appeals' characterization of this testimony is unwarranted; apparently it is the result or the cause of a series of inaccuracies and contradictions as to the purpose and content of this testimony and the nature and effect of the Company's financial structure [B. 68-69]. By ignoring the differences between ordinary mortgage bonds and *income* bonds (without fixed maturity), the ratio of bonds to value of property, *actually 63 per cent.*, becomes apparently 82 per cent. and is called "approximately 90 per cent." in the opinions of the Commission and the Court of Appeals and again in the Commission's brief [70-73]. In any event, the Company's "financial structure" is quite irrelevant. [B. 68-69.]

The Commission's brief renews the Commission's contentions that present confiscation may be justified by low returns on past investments already lost or confiscated, by confiscation in the past, as giving rise to a sort of prescriptive right to confiscate, and by confiscation elsewhere [66-69. B. 65-66, 61-65], and cites returns received by the railroads *as a whole* [69]. This citation (aside from other infirmities) confuses an *achieved average* for *all* with a *permitted maximum* for *one*. Average achievement by all must inevitably fall far short of maximum individual hope. As affirmatively appears in both of the cases that have reached this Court [B. 51-52], these achieved averages of less than 6 per cent. are derived from maxima of more—probably much more—than 8 per cent.

Each of the authorities (except a Virginia state court case) relied on or otherwise cited on the subject of rate of return in the Commission's brief [80-90] was mentioned (and listed in the table of cases) in the Company's brief, where (it is believed) all recent reported federal court cases on rate of return are collected [B. 32-51]. The cases relied on in the Commission's brief do not reflect a recent tendency away from earlier cases, but are merely extreme cases, most, if not all, of them affected by exceptional circumstances.

**IV. Value of Service.** [93-128, B. 69-83.]

On this subject the Commission's contention is: "Rates must not exceed the value of the service to the public. The Company *has failed to show* that a further increase in the rates of fare *would not be,* under the circumstances, unreasonable to the public." (Italics ours.) [93.] Thus an alleged exception to the constitutional guaranty of the opportunity to earn a fair return becomes the rule; the constitutional guaranty becomes an exception to the rule and can not be invoked without affirmatively *disproving* the application of the rule. As the argument proceeds, the constitutional

guaranty completely vanishes, since the new rule is (as the Court of Appeals says) so "indefinite and vague" that its application can neither be proved nor disproved but "can only rest in the judgment of the Commission" [B. 72-73].

The lengthy discussion centers around the unsupported assertion (contrary to the Commission's findings) that ten cents is more than a ride is worth—to be more exact, more than a ride is worth when the customer chooses to pay for four rides at 8¾ cents each, but not when he chooses to pay for a single ride. To sustain this central assertion other equally unsupported assertions are made—of which two far flung instances will here suffice, viz., (1) that the *billions* of ten cent fares paid in Boston in recent years are [97-98. B. 74-75], and (2) possibly the billions of five cent fares paid in Baltimore and elsewhere thirty years ago were [119-120], more than the value of a ride.

If "value of service to the customer" can be conceived altogether apart from cost, then there are two possible measures of such value, viz., (1) the necessary sacrifice by the Company to produce the service, *i. e.*, cost, and (2) the necessary sacrifice by the customer to get the service, *i. e.*, capacity to pay. *Both* of these measures are rejected [118, 120-121, 127-128] because they fail to support—on the contrary disprove—the assertion that ten cents is more than a ride is worth. Fares elsewhere are suggested as a possible measure [126-127]; but this measure (besides being generally impracticable [B. 63-64]) involves the special absurdity of pronouncing the billions of ten cent fares paid in Boston more than the value of a ride [97-98], as well as the mathematical absurdity of selecting an *average* as a *maximum*, thereby condemning half the items averaged, thus destroying the average and ultimately making the *minimum* anywhere a uniform level everywhere. The most "nearly perfect" measure (it is said) is the effect on riding—*not* on revenue [126-127]. If this measure means anything, it means that any fare at all is more than a ride is worth,

since any fare decreases the number of passengers who would ride if rides were free [B. 73]. To meet this test it would be necessary to abolish carfares and supplant fare boxes by alms basins.

In the discussion of "value of service"—and elsewhere—the Commission's brief discloses the far reaching consequences of the Commission's order and of the contentions now presented by the Commission's counsel to sustain the order. These contentions amount to a definition of "rate regulation" as "rate reduction" and to an assertion of arbitrary power to prevent rate *increases* when cost of service increases and to impose rate *reductions* whenever cost of service decreases. [B. 58-59.] As a sort of "text" at the beginning of the brief, it is stated that "a special problem was * * * presented to the Commission, *i. e.*, what was a just and reasonable fare to the Company when loss of revenue was due to increasing loss of patronage" [5]. To this "special" problem, and to the problem "what is a just and reasonable fare to a utility when gain in revenue is due to increasing gain of patronage," the Constitution gives the same answer, viz., a fare at least sufficient to yield a fair return on the fair value of the property. To say that when a rate is increased "the State subsidizes a declining industry" [119] means exactly the same as to say that when a rate is reduced "the State penalizes a rising industry"; each means absolutely nothing. The Commission's brief more baldly discloses its purpose: "Where rates are inherently low, * * * value of the service will not be accorded weight. Where the contrary is true, it will be accorded weight, and that weight may be controlling" [113]. In other words, when "value of service" is *greater* than cost of service, rates are limited to cost of service; when "value of service" is *less* than cost of service, rates are limited to "value of service."

In short, the whole argument about "value of service" amounts to a claim of arbitrary power in commissions to make rates by a new rule, beyond the reach of courts, which

would only work one way—always against the utility—and would obliterate the constitutional guaranty of the opportunity to earn a fair return.

Respectfully submitted,

CHARLES MCHENRY HOWARD,
CHARLES MARKELL,
HENRY H. WATERS,

*Counsel for The United Railways and Electric Company of Baltimore, Appellant in No. 55, Cross-appellee and Respondent in No. 64.*